UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

20-cv-81205-RAR

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

HEARING REQUESTED

v.

COMPLETE BUSINESS SOLUTIONS GROUP, INC. d/b/a PAR FUNDING, *et al.*,

Defendants.

_____/

DEFENDANTS' JOINT RESPONSE IN OPPOSITION TO RECEIVER'S MOTION TO EXPAND RECEIVERSHIP ESTATE

Defendants Lisa McElhone, Joseph Cole Barleta, Joseph W. LaForte, and Relief Defendant The LME 2017 Family Trust (collectively, "Defendants"), file this Response in Opposition to the Receiver Ryan K. Stumphauzer's Motion and Memorandum of Law to Expand Receivership Estate, which was filed on October 30, 2020 (the "Motion to Expand") [D.E. 357]. For the reasons explained herein, there is no basis for expanding the receivership estate and the requested relief, if allowed, would be punitive and not remedial.

I. INTRODUCTION

The Receiver claims that expansion to include several additional non-parties is "necessary and appropriate" because they were "funded with commingled investor proceeds." Mot. at 5. But the mere pooling of investor funds[1] and other funds in an account does not, without more,

[1] Par Funding disputes that the promissory notes issued during "Phase 1" as alleged in the Amended Complaint were securities as defined by the Securities Act of 1933 or the Securities Exchange Act of

constitute a violation of the securities laws, and certainly does not render the entire account subject to disgorgement. Just as the SEC must segregate ill-gotten gains from legitimate funds it seeks to freeze, the Receiver must make the same showing; otherwise, disgorgement takes on the character of a penalty. This is particularly true in this case where, unlike many SEC enforcement actions involving a receiver, Par Funding not only generated operational revenues, but received merchant deposits from MCA operations approximating two and a half times that of investor proceeds. Nevertheless, the Receiver has made no effort to show that the funds transferred to the non-parties he seeks to add to the Receivership are traceable to investor proceeds as opposed to the substantial revenues generated by Par Funding through its MCA business. Instead, the Receiver opts to engage in a lopsided analysis suggesting that every movement of every dollar, whether investor proceeds or merchant deposits from MCA operations, justifies expansion of an already costly Receivership. What's more, the Receiver erroneously argues that any non-party who received funds from Par Funding is somehow an "alter ego" of Par Funding.

Fortunately, equity requires more than conclusory assertions of an "alter-ego" relationship or "commingled" funds to expand a receivership over non-parties and a Relief Defendant who engaged in absolutely no wrongdoing. A "receivership is an extraordinary remedy that should be employed with the utmost caution and is justified only where there is a clear necessity to protect a party's interest in property, legal and less drastic equitable remedies are inadequate, and the benefits of receivership outweigh the burdens on the affected parties." *SEC v. Faulkner*, No. 3:16-CV-1735, 2018 WL 4362729, at *2 (N.D. Tex. Sep. 12, 2018). Those circumstances are not nearly present here.

1934. However, for the sake of brevity, the undersigned will refer to the gross proceeds raised by Par Funding and the Fund Managers as investor funds or investor proceeds.

In addition, there is neither urgency nor necessity justifying the alteration of the current status quo and imposing the heavy costs of a receivership and the burdens it would impose on the businesses involved. Since the inception of this case, no Defendant has transferred or spent *a single dollar* generated by the non-parties listed in the Motion to Expand for anything other than the maintenance of the properties. To prove this, the undersigned has offered the Receiver access to bank statements dating back to the commencement of the Receivership. In the absence of even the slightest evidence of dissipation, an expansion would serve only to disrupt the non-parties and the individuals they employ and diminish the value of the properties, while greatly increasing legal fees and expenses that would otherwise be collected to protect investor funds.

Expansion of the Receivership will also hinder the parties' ability to resolve this case. As of the date of the filing of this Joint Response, the parties have taken steps to resolve this case in its entirety. Expanding the Receivership now will unnecessarily impede the progress of current settlement talks by limiting the options available to the parties to negotiate a settlement. At a minimum, the Court should reserve ruling on the Motion to Expand until the parties have had a full and fair opportunity to attend mediation, which is currently scheduled for December 7, 2020.

II. ARGUMENT

"[T]he power[s] of a securities receiver is not without limits." *Eberhard v. Marcu*, 530 F.3d 122, 132 (2d Cir. 2008). Where a receiver seeks to expand a receivership, the "Receiver must be able to show beyond mere speculation that these entities should be brought within the receivership." *SEC v. Elmas Trading Corp.,* 620 F. Supp. 231, 233 (D. Nev. 1985), *aff'd*, 805 F.2d 1039 (9th Cir. 1986); *see also SEC v. Creative Capital Consortium, LLC*, No. 08-81565-CIV, 2009 WL 10664430 (S.D. Fla. Sept. 21, 2009).

The Receiver argues that expanding the receivership over the Relief Defendant and the non-parties is warranted on two grounds. First, the Receiver erroneously submits that two of the non-parties, CS 2000 and Fast Advance, "are alter egos to CBSG/Par Funding." Mot. at 7. As explained below, the Receiver misapprehends the relationship between the entities, which is based on arms-length syndication agreements. Second, the Receiver erroneously submits that disbursements made by Par Funding from accounts in which investor proceeds were pooled with merchant deposits generated by the MCA business are subject to disgorgement merely because they were "commingled." They are not. Third, the Receiver claims, without a shred of evidence, that disbursements made to pay "consulting fees" are a "sham." For these and other reasons explained below, the Motion to Expand should be denied or, at a minimum, the Court should permit discovery and an evidentiary record from a hearing, as other courts have. In all events, the Court should reserve ruling on this Motion until the parties have had an opportunity to complete mediation, which has already begun.

A. Alter Ego

The expansion of a receivership is appropriate only when the non-party participates in a "course of conduct constituting the abuse of corporate privilege," and thus, a court may not invoke this doctrine to "prejudice an innocent third party." *Elmas Trading Corp.,* 620 F. Supp. at 233. Courts consider various factors to determine whether the alter ego doctrine is appropriate, though no one factor is dispositive. *See id.* at 234 ("the conclusion to disregard the corporate entity does not, however, rest on a single factor, but often involves a consideration of the mentioned factors; the particular situation must generally present an element of injustice or fundamental unfairness"). Two such factors omitted by the Receiver are whether the entities maintained an arm's length

relationship and whether the transfers between the entities were authorized pursuant to a legitimate business purpose.[2] *Id*. Both positive factors are present here.

Conversely, in *Elmas*, the district court found alter ego liability where two negative factors were present: (1) one of the entities received money for performing consulting services for the defendants *without any evidence that services were performed* and (2) one of entities received monetary advances with no interest and no repayment date, and did not otherwise generate any earnings from its operations. *Id*. at 235–40. (emphasis added). Neither negative factor is present here.

Capital Source 2000 (CS 2000) is a merchant cash advance business. CS2000 is owned by Bill Bromley and Joe Cole. It is not owned by Lisa McElhone; it is not owned by the Trust; and it is not owned by Joseph Laforte. CS2000 does not have the same ownership as Par Funding and it does not have the same investors. It is a different company engaged in the same MCA industry. After learning that the Receiver sought to place CS2000 in the Receivership estate, Mr. Bromley's lawyer telephoned the Receiver's counsel, advised him that CS 2000 was owned by Mr. Bromley and Mr. Cole, and provided corporate documents confirming ownership. The Receiver's counsel's sole source of "ownership" is that the company was listed on an emailed financial projection prepared for use during an estate legal consultation. As set forth in detail in Defendants' Joint Response dated October 30, 2020 at pp. 26-28 (DE 355), that document was a rough draft of a hypothetical prediction of possible values 10-15 years from now. It was prepared as a discussion

[2] In *Elmas*, the Receiver found various transactions between the corporate defendant and entities with no explanations for various transfers. This is unlike our case where the money transfers were pursuant to a legitimate syndicate deal.

piece for a first meeting with an estate lawyer and projected a possible financial condition years into the future.[3]

CS2000 has its own investors who invest in CS2000 MCA contracts. CS2000 participates in syndications of some of Par Funding's MCA contracts, a common practice in the MCA industry to leverage and reduce risk. Syndication simply means where one or more MCA companies invest in a group of MCA contracts to reduce risk. CS2000 paid fees to CBSG for processing of those syndication contracts. The fact that the Receiver sees financial transactions between CS2000 and Par funding is no surprise at all. Par Funding paid CS2000 according to the terms of the syndication agreements. There is nothing nefarious about the transfer of funds between CS2000 and Par Funding (DE 357 at pg. 8), since CS2000 participated in some of Par Funding's MCA syndications.[4]

Fast Advance Funding ("FAF") is a very small separate MCA company owned by the Trust. The only and early investors were family and close friends. Its MCA portfolio is different from that of Par Funding. Moreover, most of the early investors in Fast Advance Funding were fully paid all of their principal and interest by early 2019. There are only three investors in FAF today, and none of them are investors in Par Funding.[5]

The transfer of funds between Par Funding, CS2000 and Fast Advance were pursuant to a legitimate business purpose. *Compare Elmas*, 620 F. Supp. at 234. The Receiver asserts that:

> Par Funding received approximately $97.17 million in deposits/credits from CS2000 and made payments totaling $76.67 million to CS2000. Similarly, Par

[3] The estate attorney financial projection listed a number of entities which neither Ms. McElhone nor the Trust own. However, those entities might have been a future source of revenue.
[4] Moreover, the bank account for CS2000 is frozen and no transfer of funds has occurred since late July 2020 or can occur.
[5] The bank account for Fast Advance Funding is frozen and no transfer of funds has occurred since late July 2020 or can occur.

> Funding received approximately $12.5 million in deposits/credits from Fast Advance and made payments totaling $17.09 million to Fast Advance.

Mot. at 7. But as shown herein, this is only half the picture. The Receiver failed to mention the arm's length MCA syndication relationship between Par Funding, CS2000, and Fast Advance which fully explains these transfers. As noted above, in the MCA world, syndications are a standard practice to reduce and leverage risk.

CS2000 and Fast Advance are separate and distinct corporations that provide capital to small businesses. Pursuant to syndication agreements Par Funding had with other merchant cash advance businesses like CS2000 and Fast Advance, each company would fund a select group of merchants defined by the syndication agreement, allowing each to leverage the risk associated with those MCA deals. Because the transfers reflect legitimate arm's length business deals between the entities in which each respective party shared in the risk, they each had a legitimate claim to the funds they received. *Compare Elmas*, 620 F. Supp. at 234 (invoking the alter ego doctrine where various transactions existed between the corporate defendant and entities with no legitimate explanations for the transfers).

The Receiver did not know this and, to our knowledge, did not research the basis for these transactions prior to filing the Motion to Expand. The Receiver defaulted to the conclusion that the transfers were made pursuant to an alleged fraudulent scheme in order to erroneously rely on *Torchia*[6], *Creative Capital Consortium*[7], and *RaPower-3, LLC*.[8] But these cases have no applicability to the actual facts here. For example, the Receiver cites to *Torchia* for the proposition that alter ego liability should attach where there has been a consistent commingling of assets. But

[6] *SEC v. Torchia*, No. 1:15-cv-3904-WSD, 2016 WL 6212002, at *3 (N.D. Ga. Oct. 25, 2016).
[7] *SEC v. Creative Capital Consortium, LLC*, Case No. 08-81565, 2009 WL 10664430, at *1 (S.D. Fla. Sept. 21, 2009).
[8] *United States v. Rapower-3, LLC*, Case No. 2:15-cv-00828-DN, 2019 WL 2195409, at *3 (D. Utah May 3, 2019).

this is only true where the related entities rely on the corporate defendant to fund and operate their businesses without compensation, a fact not present here. *Id.* at 1.

Likewise, the Receiver's reliance on *RaPower-3* is misplaced. In *RaPower-3*, the court found that the corporate defendant: (1) created and controlled the related entities; (2) transferred funds to the related entities as a means of concealing assets; and (3) each of the related entities were subsidiaries of the corporate defendant. Accordingly, in *RaPower-3*, the related entities did not have an independent existence, but instead were created to serve as a conduit to carry out the corporate defendant's fraudulent scheme. There are no similar facts here.

Similarly, the Receiver's reliance on *Creative Capital Consortium* is misplaced. There, the district court found that alter ego liability may attach when the corporate defendants controlled the related entities, had authority to transfer funds between the entities, and shared the same address and corporate officers with the related entities. But those circumstances do not exist here. As stated above, CS2000 and Fast Advance are separate and distinct entities owned by other parties that are not Par Funding; Par Funding has absolutely no authority to authorize transfers between the entities; and the respective entities do not have the same corporate officers.

Because Par Funding has not used either entity to transact its own affairs or conceal any alleged fraudulent behavior, there is no basis to invoke alter ego liability and the Court should not do so. *Johnson v. New Destiny Christian Center Church, Inc.*, 303 F. Supp. 3d 1282, 1288 (M.D. Fla. 2018) (refusing to invoke the alter ego doctrine where the plaintiff's claim that an entity was the alter ego of the corporate defendant was "plainly unsupported" and contradicted by the record).

B. "Commingling" is Not a Securities Violation.

The commingling of investor funds is not actionable absent a material misrepresentation or an omission. *See, e.g.*, *SEC v. LA Trust Deed & Mortg. Exchange*, 186 F. Supp. 830, 852 (S.D.

Cal. 1960); *Cordova v. Lehman Bros., Inc.* 526 F. Supp. 2d 1305, 1315 (S.D. Fla. 2007), *rev'd on other grounds*, 332 Fed. Appx. 549 (11th Cir. 2009) (dismissing plaintiff's complaint for, *inter alia*, failure to identify with particularity any representations that defendants asserted that defendants would keep funds segregated); *Cf. SEC v. George,* 426 F.3d 786, 788-89 (6th Cir. 2005) (concluding that defendants committed securities fraud by telling potential investors that their funds would be invested in certain types of securities, but then commingling the funds and using them "to pay purported profits to other investors or to make extravagant personal purchases"). In short, absent evidence of some wrongdoing, commingling alone is not actionable. *I-Lighter, Inc. v. E-Z Media, Inc.*, No. 07-60843-CIV, 2008 WL 750217, at *2 (S.D. Fla. Mar. 19, 2008) (finding that the plaintiff's allegation that an entity and a corporate defendant "co-mingled assets and transferred assets for inadequate consideration" was insufficient to pierce the corporate veil absent some showing that these actions were rooted in wrongdoing).

Here, neither the Receiver (nor the SEC) has alleged that Par Funding represented to investors that it would keep certain funds segregated or that it commingled assets for some improper purpose. *Compare LA Trust Deed & Mortg. Exchange*, 186 F. Supp. at 852. Because the purpose of appointing a receiver "is to facilitate enforcement of any disgorgement remedy that might be ordered in the event a violation is established at trial," *see SEC v. FTC Capital Markets, Inc.*, No. 09-CIV-4755, 2010 WL 2652405, *3 (S.D.N.Y. June 30, 2012), and the mere commingling of investor proceeds with operating revenues would not alone support disgorgement of those pooled funds, expansion on these grounds is not warranted. *See also U.S .v Puche*, 350 F.3d 1137 (11th Cir. 2003) ("The mere pooling or commingling of tainted and untainted funds in an account does not, without more, render the entire contents of the account subject to forfeiture.")

Moreover, the mere pooling of tainted and untainted funds does not alone support disgorgement of the entire amount of those funds. Rather, a receiver must make a reasonable effort to trace or segregate tainted funds from untainted funds before efforts to secure those funds (or assets purchased with those funds), are warranted.

C. The Receiver Must Make Reasonable Efforts to Trace Tainted Funds

The Receiver's powers are not unlimited.[9] *Eberhard v. Marcu*, 530 F.3d 122, 132 (2d Cir. 2008). Much like the SEC, the Receiver must make a reasonable showing that an asset was purchased with tainted funds, and not merely commingled funds, before seeking to disgorge the asset or include it in the receivership.

With respect to the SEC, several courts have recognized that because "disgorgement may not be used punitively," the SEC "must distinguish between legally and illegally obtained profits." *SEC v. First City Financial Corp.*, 890 F.2d 1215, 1231 (D.C. Cir. 1989); *accord Commodity Futures Trading Comm'n v. British Am. Commodity Options Corp.*, 788 F.2d 92, 93 (2d Cir. 1986) ("generally, where benefits result from both lawful and unlawful conduct, the party seeking disgorgement must distinguish between the legally and illegally derived profits"); *see SEC v. Wills*, 472 F. Supp. 1250, 1276 (D.C. Cir. 1978) ("when the amounts to be disgorged cannot be related with sufficient certitude to defendants' securities law violations, the SEC's disgorgement request takes on the character of a plea for punitive relief."); *SEC v. First City Fin. Corp.,* 890 F.2d 1215, 1231 (D.C. Cir. 1989) ("the court may exercise its equitable power *only* over property causally

[9] In *CFTC v. Sidoti*, 178 F.3d 1132, 1137 (11th Cir. 1999), the district court improperly ordered disgorgement for a period that was not causally connected to any evidence of fraudulent activity. The Eleventh Circuit court noted that "the district court should keep in mind the limitation placed on its equitable powers by this requirement that there be a relationship between the amount of disgorgement and the amount of ill-gotten gain." *See also SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1105 (2d Cir. 1972) (finding that the district court improperly included the legitimate profits and income earned in the disgorgement amount, rather than just limit the order to the illicit proceeds).

related to the wrongdoing."); *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1105 (2d Cir. 1972) ("ordering the disgorging of profits and income earned on proceeds is in fact a penalty assessment.").

Just as the SEC must segregate ill-gotten gains from legitimate funds it seeks to freeze,[10] the Receiver must make the same showing. *See, e.g.*, *In re Alpha Telcom, Inc.*, No. CV 01-1283-PA, 2005 WL 488675, at *3 (D. Or. Feb. 1, 2005). In *Alpha Telcom*, the Receiver sought disgorgement of the proceeds several sales agents received in connection with the sale of unregistered securities. *Id.* at *3. One such sales agent received $109,360 in commissions but contended that only $61,400 was causally connected to the fraud and that the remaining $47,960 was received for legitimate purposes. *Id.* The Receiver argued that because the funds paid to the sales agent came from "a bank account containing money derived from . . . investors and the operating revenues of the company," *all* funds paid to the sales agent must be disgorged. *Id.*

The district court rejected the Receiver's argument. The court ruled that the Receiver was required to make a showing that the remaining $47,960 the sales agent received in commissions was connected to the sale of the unregistered securities, *i.e.*, the alleged fraudulent activity. *See generally FTC Capital Markets,* 2010 WL 2652405, at *8 (holding that the simple assertion that funds were transferred from one account to another is insufficient to establish that "funds held by entities not alleged to have been involved in any wrongdoing are traceable to fraud").

Like the receiver in *Alpha Telecom*, the Receiver here has done *nothing* to trace the funds transferred out of Par Funding's accounts to investor proceeds as opposed to legitimately earned

[10] *See, e.g.*, *SEC v. McGinn*, No. 10-CV-457 GLS/DRH, 2012 WL 1142516 at *5 (N.D.N.Y. Apr. 4, 2012) (assessing various accounts and finding that where illegitimate funds were commingled with legitimate funds, the two categories were severable and limited the amount of the asset freeze to only the amount of the illegitimate funds).

Par Funding MCA deposits. The Receiver simply contends that the Receivership Entities disbursed funds from accounts containing "commingled proceeds." Mot. at 8. For example, the Receiver suggests that:

- Between July 2015 and July 2020, Par Funding transferred approximately $42,334,600.00 in commingled investor funds to HBC.
- Between July 2015 and July 2020, Par Funding transferred approximately $42, 643,174.00 to Eagle Six.
- Between July 2016 and April 2019, Par Funding transferred approximately $4.9 million in commingled investor funds to Beta Abigail.
- Between February 2017 and November 2019, Par Funding transferred approximately $9.5 million in commingled investor funds to New Field.

Mot. at 9.

Just as tainted and untainted funds received in an account can be segregated before funds from the account are disgorged to avoid a punitive effect, courts have applied various approaches to trace funds in an active account comprised of commingled funds. *See United States v. Banco Cafetero Panama*, 797 F.2d 1154, 1159 (2d Cir. 1986) (discussing the lowest intermediate balance rule, the averaging rule, and "drugs-in, first-out" rule). The lowest intermediate balance rule "attempts to divide tainted and untainted money" when proceeds are commingled with other funds. *SEC v. Kaleta*, No. 4:09-3674, 2011 WL 6016827, at *2 (S.D. Tex. Dec. 2, 2011); *In re Lee*, 574 B.R. 286, 295 n. 52 (Bankr. M.D. Fla. 2017).

The "lowest intermediate balance" rule was employed by the *In re Lee* bankruptcy court in Tampa, Florida to impose a constructive trust on the Florida homestead of debtor and his wife only to the extent that false profits paid to the couple as innocent investors in a Ponzi scheme were traceable to their home. *Id.* The receiver was not entitled to an equitable lien on the entire value of the couple's Florida homestead simply because the $227,126.78 used to purchase it represented tainted funds. A significant concern for the court in selecting an appropriate tracing rule was

avoiding "unjust enrichment" to the receiver of illicit funds (as opposed to a penalty). In relevant part, the *In re Lee* Court stated:

> The "lowest intermediate balance rule" is an acceptable method for treating trust proceeds that have been commingled with other funds: where trust funds are commingled in an account they are considered as undiminished so long as the total account balance is at least equal to the amount of the trust fund deposits. If the aggregate amount of trust deposits exceeds the lowest intermediate balance in the account, they are considered lost. Thus, "the lowest intermediate balance in a commingled account represents trust funds that have never been dissipated and which are reasonably identifiable." This method has been approved by courts in cases requiring the tracing of money through accounts where assets have been commingled.

Id. at 296.

Here, the consulting fees at issue were transferred to Ms. McElhone, Mr. Laforte, and Mr. Cole, among others, on a quarter by quarter basis.[11] On each such occasion, the amount of merchant deposits generated by the MCA business well exceeded investor deposits received for the quarter. Consequently, on a quarter by quarter basis, the total account balance always exceeded new investor deposits even after quarterly consulting fees were distributed.[12]

Moreover, the Receiver's unsupported claim that the consulting fee agreements were "sham" agreements merely because they were paid to insiders is simply wrong. *See Wills*, 472 F.Supp. at 1276 (amounts paid to executives for services rendered are not disgorgeable); *SEC v.*

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[11] Prior to 2016, no consultant fees were taken and all profits went back into the business to fund more MCA contracts. By 2016, Par Funding's fourth year, its business had grown and ample interest was consistently paid to investors. A decision was then made to compensate those who built the successful business. DLA Piper was retained to advise on and draft profit sharing and consulting agreements. The consulting fees paid were not pegged to investor funds received but, importantly, to a percentage of MCA contracts and/or retained earnings. In prior filings, Defendants have shown the profitability of Par Funding which easily supported the consulting fees paid. [DE 84, 106, Ex. A, 115, 132, 148, pp. 21, 25].

[12] Defendant Lisa McElhone issued a Request for Production to the Receiver in order to obtain Par Funding's books and records. The Receiver has yet to produce a single document to Ms. McElhone. *See SEC v. Aquacell Batteries*, No. 6:07–cv–608, 2008, WL 2915064, at *1 (July 24, 2008) (permitting non-parties whose property the receiver sought to include in the receivership the opportunity to conduct discovery and an evidentiary hearing thereafter on the receiver's motion.) We request the same opportunity to obtain discovery and a hearing on the Receiver's instant Motion for Expansion.

Boyd, No. 95-CV-03174, 2012 WL 1060034, at *9 (D. Colo., Mar. 29, 2012) (denying SEC's request for disgorgement of compensation received by defendant in securities fraud scheme because there was no evidence that he received the compensation for his participation in the scheme as opposed to legitimate work he provided for the issuer); *SEC v. True North Finance Corp.*, 909 F.Supp.2d 1073, 1126 (D. Minn. 2012) (denying SEC's summary judgment motion requesting disgorgement of Fund CEO's compensation where genuine issue of fact remained regarding whether fees he earned were connected to his efforts to keep the Fund going even though it had defaulted and was speeding towards bankruptcy.)

The Receiver's reliance on *Torchia* for the proposition that the transfer of commingled investor funds alone justifies expansion is also misplaced. As stated above, *Torchia* involved entities that were the alter egos of the corporate defendant, which is not the case (and not even alleged by the Receiver) here.

The Receiver's reliance on *SEC v. Nadel*, No. 8:09-cv-87-T-26TBM, 2013 WL 2291871, at *2 (M.D. Fla. May 24, 2013) and *CFTC v. Hudgins*, 620 F.Supp.2d 790, 793 (E.D. Tex. 2009), is also misplaced. The Receiver cites to *Nadel* and *Hudgins* for the proposition that the Receivership can be expanded to include entities that were funded with "scheme proceeds" from defrauded investors. Mot. at 10. In *Nadel*, the court found that the "vast majority" of the funds at issue were tainted, and *Hudgins* involved a Ponzi scheme, where all of the funds at issue were tainted. In this case, Par Funding's MCA merchant deposits comprised no less than 250% of investor deposits, which is why a tracing analysis is necessary.

For these same reasons, the Receiver has failed to demonstrate whether any investor funds were used to purchase the nineteen real estate properties or Ms. McElhone's personal properties. Mot. at 11-15, 18. *See, e.g.*, *In re Alpha Telcom, Inc.*, 2005 WL 488675, at *3. Just as the Receiver

in *Alpha Telcom* was not entitled to all the proceeds paid from an account containing commingled funds, a receivership expansion over properties solely because they were allegedly purchased with funds from accounts containing commingled funds would be punitive without a careful and thorough tracing analysis. *See also FTC Capital Markets,* 2010 WL 2652405, at *8 (holding that the simple assertion that funds were transferred from one account to another is insufficient to establish that "funds held by entities not alleged to have been involved in any wrongdoing are traceable to fraud").

The Receiver relies on *SEC v. Lauer*[13] to support the proposition that the Receiver may expand the receivership over properties that were allegedly purchased using significant proceeds of the fraud. Mot. at 20. *Lauer*, however, does not stand for this proposition. In *Lauer*, the defendant sought to make the proceeds from the sale of his condominium available to himself for defense fees and costs. *Id.* at *2. The defendant contended that he was entitled to these proceeds because he purchased the property at a time when he did not engage in any fraudulent activity. *Id.* The court found while this may have been true, the defendant also *maintained* the property during the fraudulent period using tainted funds. Accordingly, the court ruled, "for purposes of this case, that when tainted funds are used to pay costs associated with maintaining ownership of the property, the property itself and its proceeds are tainted by the fraud." *Id.* at *3. The court explained, "since [the defendant's] use of tainted funds allowed him to maintain ownership . . . this case does not present a 'mere commingling of tainted and untainted'" funds. *Id.* at *3.

Accordingly, the requirement that the Receiver must make a reasonable effort to separate the alleged ill-gotten gains from legitimate proceeds is valid law and required here. *See generally*

[13] *SEC v. Lauer*, No. 03-80612-CIV, 2009 WL 812719, at *3 (S.D. Fla. Mar. 26, 2009).

Puche, 350 F.3d at 1153 ("the mere pooling or commingling of tainted and untainted funds in an account does not, without more, render the entire contents of the account subject to forfeiture.").

D. Expansion of the Receivership Over the Trust, a Relief Defendant, is Improper

The Receiver also seeks to expand the Receivership over the 2017 LME Family Trust, a Relief Defendant. Mot. at 16. Its only stated reason for this extraordinary request is the baseless claim that the Trust was "an active participant in the fraud scheme" because it used Trust assets to buy real estate. However, the fraud scheme that is "the subject matter of the litigation" is a securities fraud scheme in which the Trust—according to the SEC—played only a passive role. *SEC v. World Capital Market, Inc.*, 864 F.3d 996, 1004 (9th Cir. 2017). The Trust's use of the funds it received to purchase real estate which—by all accounts, remain in the Trust to this day—does not make it an active participant in the securities fraud scheme, or for that matter, any other scheme. The Trust did not hide any assets, conceal the nature or source of the funds it received from Par Funding, or transfer the funds to entities outside the Trust. Moreover, because neither the Receiver nor the SEC has demonstrated that the funds received by the Trust were investor proceeds and not Par Funding's merchant deposits from its MCA business, to which the Trust as Par Funding's owner would be entitled to a share, expansion based on the Trust's use of those proceeds must be denied.

Next, the Receiver claims that the Trust is an "alter ego" of Lisa McElhone, its Grantor. Despite its reliance on *Torchia*, however, the Receiver cites no evidence even suggesting that "money flowed back and forth" between Ms. McElhone and the Trust; that she has any ownership interest in assets purchased by the Trust (she does not); or that Ms. McElhone acted in a manner

inconsistent with her role as its Grantor. 2016 WL 6212002, at * 4. Accordingly, *Torchia* is inapposite and the Receiver's request to include the Trust in the receivership should be denied.[14]

E. Personal Property Purchased by Ms. McElhone

For the reasons stated herein, the Court should deny the Receiver's request to expand the Receivership over the three personal properties identified as the Haverford, Paupack, and Jupiter properties. First, the Receiver has failed to trace the funds Ms. McElhone received to investor funds rather than the income legitimately earned by Par Funding. And, as an owner, Ms. McElhone had a legitimate right to receive compensation pursuant to a consultant agreement with the company. *See Wills*, 472 F.Supp. at 1276 (amounts paid to executives for services rendered are not disgorgeable); *Boyd*, 2012 WL 1060034, at *9 (denying SEC's request for disgorgement of compensation received by defendant in securities fraud scheme because there was no evidence that he received the compensation for his participation in the scheme as opposed to legitimate work he provided for the issuer); *True North Finance Corp.*, 909 F.Supp.2d at 1126 (denying SEC's summary judgment motion requesting disgorgement of Fund CEO's compensation where genuine issue of fact remained regarding whether fees he earned were connected to his efforts to keep the Fund going even though it had defaulted and was speeding toward bankruptcy.) Consequently, the assets Ms. McElhone purchased using the consulting fees she received are not disgorgeable and certainly are not grounds for the drastic remedy of expansion of the receivership over those assets.

F. Expansion of the Receivership over the Real Estate Assets is Not Necessary and Will Result in Diminishment of Their Value as well as Increased Expenses

[14] The Receiver's request for an expansion based on speculation that Trust assets "may be subject to further dissipation," *see* Mot. at 17, should give the Court some pause. Having failed to demonstrate that the Defendants have dissipated any assets since the date of the SEC's Complaint, the Receiver cannot reasonably argue that expansion of the receivership is warranted based on the unfounded and purely speculative assertion that Trust assets *may* be dissipated.

The Receiver seeks to expand the Receivership to add over nineteen real estate entities as well as the Defendants' personal real estate, discussed above. First, there is no basis to expand the Receivership to include these properties. Second, it is wholly unnecessary as the properties are very well managed and are not going anywhere. Third, and perhaps most important, it is of paramount importance to maintain the current *status quo* of these properties in order to protect the residential and commercial tenants, the properties and the surrounding neighborhoods, and the value of these buildings. As we show herein, these properties have not been and will not be transferred or sold and will continue to be maintained and managed by the current property management company. In addition, it is critical for the financial well-being of the properties that its residential and commercial tenants receive uninterrupted services including building cleaning, repairs and maintenance of the properties and their rental units. Adding these properties to the Receivership will do nothing but create additional expenses and legal fees that will detract from the monies available for investors, while doing nothing to preserve, much less add value to the properties.

The Receiver states in footnote 55 that "these properties are overseen by an experienced Philadelphia property manager and if the motion is granted the Receiver anticipates maintaining the property manager's oversight." However, the property manager only makes sure that the rent is paid and shows and rents the apartments and stores to potential tenants.

The most important aspect of maintaining and managing these 26 commercial and residential buildings is providing the essential services for the buildings. And this is not done by the property manager. This work entails hiring and supervising the cleaning staff, completing repairs and doing maintenance, managing staff and being responsive to trouble-shoot any problems that arise. Rapid responses to residential and commercial tenants requires a full-time staff and a

reliable group of handymen, plumbers, custodians and other service people. When a pipe bursts in the middle of the night or a window needs replacement or snow needs to be cleared from the sidewalks, long-standing relationships with repairmen, plumbers and the like are essential. It cannot be done remotely. The relationships with services providers have been built with trust over time and are the key to well-maintained buildings and worry-free tenants. Particularly now with Covid-19 and the attendant cleaning requirements for common spaces, cleaning companies are booked well in advance. It would ill-serve the tenants of these buildings and the public in the neighborhoods where these buildings are located, to have a bunch of lawyers try to manage these buildings remotely. The Defendants have been very hands-on managing these buildings and that is why they are in excellent shape and have contented tenants. It is not just the Defendants who would be impacted by a Receivership over these buildings, but real tenants for whom these buildings are their homes and livelihood.

Were the Receiver to take over, they would have to hire additional staff to manage these buildings and would be starting from square one. The time lag, particularly during the continuing Covid-19 crisis and the upcoming holiday season, would result in serious delays providing services for residential and commercial tenants. Moreover, the Receiver would incur substantial expenses managing these residential and commercial buildings.

Finally, there is absolutely no reason for the expansion. As banking records show decisively, aside from the daily and monthly management costs of running these properties, no funds have left the entity bank accounts. No entity funds have gone to the Defendants. The buildings cannot be sold or transferred. There is thus nothing an expansion will accomplish except diminishing the services provided to tenants; depreciating the value of the buildings; and paying

more legal fees out of the Receivership estate. Beyond that, there is nothing that an expansion will accomplish.

G. Expansion of the Receivership is Neither Necessary nor the Least Drastic Equitable Remedy Available

Even assuming, *arguendo*, that there were a basis for this Court to exercise its equitable authority to add the assets described in the Receiver's Motion to the Receivership, there are far less draconian measures available that would maintain the status quo without the heavy cost of a Receivership and the burdens it would impose on the businesses involved. To begin with, the Court could impose a *lis pendens* on the properties. All of the Defendants are already subject to an asset freeze which prohibits them from transferring or disbursing any assets for their personal benefit. The Defendants have offered the Receiver access to bank statements for each of the non-party entities dating back to the inception of this case (July 28, 2020), to prove that no funds generated by the non-parties listed in the Motion to Expand have been spent for anything other than the maintenance of the businesses and properties. There is no evidence that any of the subject properties have been sold or that any money has been dissipated.

Moreover, the benefits of an expanded receivership in this case are far outweighed by the burdens on the affected parties. *Faulkner*, 2018 WL 4362729, at *3 (declining to expand receivership as to an entity subject to a defendant's control, notwithstanding that the entity had received commingled investor funds from an allegedly fraudulent scheme, because "the benefits of placing [the entity] in receivership are outweighed by appurtenant burdens…") Here, expanding the receivership is neither necessary nor appropriate given the availability of less draconian measures and controls already in place. Moreover, the burden on the parties involved, including the businesses already under contract to manage and maintain the properties, the employees of those businesses, and the tenants who live on the properties, will be significant if the Receiver

takes over managing the companies. As occurred in connection with Par Funding, the transition alone will burden several innocent parties and incur substantial costs. And the efficiencies built into long-standing service relationships will disappear. Moreover, the additional costs associated with managing the properties under a receivership will reduce the value of the properties.

Finally, expansion of the Receivership will hinder the parties' ability to resolve this case fully and finally. The parties are working toward settlement of the SEC's case, and the restrictions imposed through the requested expansion will negatively impact settlement discussions.

III. CONCLUSION

For all of the foregoing reasons, the Receiver's Motion to Expand should be denied. In the alternative, an evidentiary hearing should be granted. Further, in all events, a ruling on the Motion to Expand should be deferred until after the Mediation on December 7, 2020.

Respectfully submitted,

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